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BEFORE THE ARIZONA CORPORATION COMMISSION**COMMISSIONERS**

KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE APPLICATION OF
ARIZONA PUBLIC SERVICE COMPANY FOR A
HEARING TO DETERMINE THE FAIR VALUE OF
THE UTILITY PROPERTY OF THE COMPANY
FOR RATEMAKING PURPOSES, TO FIX A JUST
AND REASONABLE RATE OF RETURN
THEREON, TO APPROVE RATE SCHEDULES
DESIGNED TO DEVELOP SUCH RETURN.

Docket No. E-01345A-08-0172

**AIC CLOSING BRIEF IN
SUPPORT OF SETTLEMENT
AGREEMENT**

The Arizona Investment Council ("AIC"), on behalf of its some 6,000 members, submits this Closing Brief. The AIC strongly supports the Proposed Settlement Agreement dated June 12, 2009 (the "Settlement Agreement").

Among many other things, it gives Arizona Public Service Company ("APS" or the "Company") an opportunity to improve its perilously low bond ratings and to attract capital at reasonable rates, while requiring \$150 million in expense reductions and the issuance of \$700 million in equity. Further, it assures rate stability for customers to and into the year 2012. All of this carries an average bill impact for the residential customer of less than one percent.¹

INTRODUCTION

It is neither overstatement nor hyperbole that this Settlement Agreement has no parallel in the Commission's regulatory history. AIC President Gary Yaquinto served as Utilities Division Director for nine years during much of the 1990s. In that capacity, he was responsible for negotiating several rate settlements with APS. He testified that none of those agreements

¹ APS Exhibit 37.

1 came “even close” to being as comprehensive as this contract, nor did they have the degree of
2 universal support that this Settlement Agreement enjoys.²

3 In that regard, more than 20 parties ranging from the Company through energy efficiency
4 and renewables advocates, from the AIC investors group to the Residential Utility Consumer
5 Office, from the Arizona School Boards Association to Freeport-McMoRan and from low-
6 income advocates to merchant power plants negotiated for months, drafted for weeks and
7 testified for days in unqualified support of the Settlement Agreement:

- 8 ● “The Settlement Agreement is a comprehensive strategy that provides a guiding hand
9 for the utility to improve its financial condition in both the short and long term... The
10 Settlement Agreement helps to align the interests of stockholders and ratepayers...”
RUCO Director Jodi Jerich, RUCO-1, p. 11, ll. 3-11. (Emphasis supplied.)
- 11 ● “Staff believes that the Agreement is fair to ratepayers because it results in just and
12 reasonable rates for customers [and] is fair to the utility... [T]his proposal balances
13 many diverse interests... [and] promotes the public interest. Former Staff Director
Ernest Johnson direct testimony, adopted by Assistant Director Elijah Abinah, S-1,
pp. 10-11.
- 14 ● “Improved financial health for APS also benefits customers by lowering the cost of
15 capital faced by APS [and] I would also point out that... customers are also assured of
no further base rate increases for a period of at least two and a half years.” AIC
President Gary Yaquinto, HR TR, p. 2257, ll. 10-19.
- 16 ● “[T]he agreement is in the public interest. Of particular importance, it specifies
17 actions for advancing renewable energy and energy efficiency and for moving
Arizona toward a new energy economy.” WRA Senior Policy Advisor David Berry,
18 WRA-2, p. 12, ll. 32-34.
- 19 ● “[T]he elements contained in the agreement are beneficial to low-income rate payers,
20 to the Company and to the greater community of rate payers.” Cynthia Zwick,
Zwick-1, p. 2.

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 ² HR TR, p. 2259, ll. 2-17.

- “The Agreement contains detailed and far-reaching provisions necessary to promote a sustainable energy future for Arizona... But it is not just the commitment to pursue these resources and programs that is reflected in the Agreement—it is the financial support to achieve that vision that is equally critical.” APS Vice President Jeffrey Guldner, APS-12, p. 3, l. 22-p. 4, l. 4.
- “The proposed settlement agreement greatly assists our member school districts in their efforts to conserve energy, reduce their utility demand and ultimately reduce the energy expenses and is strongly supported by our organization.” Robert Rice, President, Arizona School Boards Association, ASBA-1, p. 3, ll. 20-22.
- “[T]he party I represent in this proceeding has a strong interest in seeing rates being held as low as reasonably possible; at the same time they have a strong interest in seeing that the utility remains financially viable... I believe that every last nickel was rung out of this deal on behalf of customers.” Kevin Higgins, on behalf of Freeport-McMoRan and Arizonans for Electric Choice and Competition, HR TR, p. 240, ll. 9-17. (Emphasis supplied.)

This Settlement Agreement is far more than a rate case resolution. It is a comprehensive mix of elements which together comprise a sustainable path to Arizona's energy future.

ARGUMENT

The Settlement Agreement begins a process of positioning APS as a more viable competitor in the most massive competition for investment dollars that Arizona and this nation have ever seen. The numbers framing that competition are staggering. The Brattle Group estimates that, even netted for savings projected from aggressive energy efficiency programs, U.S. electric industry infrastructure demands will total \$1.5-2 trillion over the next 20 years.³ Arizona and APS need a significant slice of that pie.

Last year, the AIC released a study prepared by the ASU Seidman Research Institute entitled “Infrastructure Needs and Funding Alternatives for Arizona: 2008-2032.” It concluded

³ APS-1, DEB-2.

1 that Arizona electricity demand will increase by about 85% over the next 25 years, requiring a
2 capital investment of roughly \$80 billion.⁴

3 The Company will spend over \$15 billion on improvements and additions between now
4 and just 2025.⁵ In the Settlement Agreement, APS commits to making those investments and
5 expending its efforts in a variety of ways, including significant increases in renewables and to
6 energy efficiency. But, as Mr. Yaquinto testified:

7 For APS to succeed in serving its customers today and tomorrow, it must
8 demonstrate to the capital markets its ability to repay debt obligations and to
9 generate earnings at levels sufficient to attract and retain equity investors.
10 Especially in light of the recent and very dramatic instability in the debt and
11 equity markets, the outcome of this rate case is critical for APS' access to these
12 capital markets as well as its ability to compare positively against other utility
13 companies...⁶

14 Right now, APS simply does not compare positively to other utilities. Of 141 rated
15 utilities throughout the country, only one is rated lower than APS.⁷ The Company's earned
16 returns have been and continue to be significantly below those of other utilities which are
17 searching for the very same investment dollars that APS and Arizona need.

18 As Mr. Hatfield testified:

19 Our returns are simply not competitive. If you look at the [APS Exhibit 35]
20 graph in 2004, the industry earned on average 10.6 percent while APS earned
21 only 8.9 percent, 16 percent below the industry average... In 2008, when the
22 industry earned 9.8 percent, APS earned only 7.6 percent, some 22 percent
23 below the industry average.⁸

24 RUCO expert Dr. Ben Johnson also talked about the impacts of recent market risk
aversion and rating agency attitudes. Noting that it was particularly important in these times to

⁴ APS-1, p. 20, ll. 10-19.

⁵ APS-31, Hatfield Direct, p. 7, ll. 21-24.

⁶ AIC-1, p. 4, ll. 1-6. (Emphasis supplied.)

⁷ APS Ex. 35, HR TR, p. 2391, ll. 9-14.

⁸ HR TR, p. 2393, l. 23-p. 2394, l. 10.

1 minimize the impression that it is risky to invest in Arizona, Dr. Johnson pointed out that ratings
2 agencies today would be much more likely to go ahead and lower APS' barely investment grade
3 rating if the result of this rate case was disappointing: "You don't want to be the poster child of
4 how the rating agencies are getting tougher."⁹ It is abundantly clear that should this status quo
5 continue, there is no way the Company can effectively compete for the dollars necessary to move
6 Arizona to the new energy economy envisioned in the Settlement Agreement.

7 The Settlement Agreement provides several tools to begin to change this status quo and,
8 as Dr. Johnson put it, the impression that it is risky to invest in the Grand Canyon State. While
9 considerably below APS' original request, Mr. Yaquinto testified that the total non-fuel base rate
10 increase of slightly more than \$196 million appears adequate to meet the Company's near term
11 debt/equity market and financial challenges:

12 Second and equally important, the Settlement Agreement recognizes the need for
13 earnings stability beyond just the present by incorporating a schedule for filing
14 and processing rate adjustments in 2012 and 2014. The scheduling of future rate
cases combined with procedures aimed at reducing regulatory lag promotes
earnings stability and reduces uncertainty. Investors view both as a positive sign.

15 * * *

16 Several other provisions of the Settlement Agreement also support the Company's
17 financial performance over a longer term. For example, the treatment of
18 proceeds...under Schedule 3 as revenue helps support the Company's earnings
19 picture... Also, APS' ability to defer a portion of pension and other post-
retirement benefits increases in 2011 and 2012 is positive and the potential 2012
depreciation expense treatment of any Palo Verde life extension (if secured) will
also help support earnings.¹⁰

20 It's important, however, to note the balance reflected in these provisions. APS has settled for
21 and is assured a much smaller initial rate increase than it originally requested. But, it has done so

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23 ⁹ HR TR, p. 1924, ll. 22-23.

24 ¹⁰ AIC-1, p. 5, ll. 15-22.

1 only on the hope, not the assurance, that a certain amount of Schedule 3 revenues will
2 materialize and the Nuclear Regulatory Commission will act affirmatively on the life extension
3 request.

4 Further, this is, by no means, a generous Settlement Agreement. For example, a total of
5 \$150 million in expense reductions over the next five years is required.¹¹ As Mr. Guldner stated,
6 “[i]t still results in our prices being below our cost in 2010 by about \$80 million.”¹² As
7 Mr. Wontor discussed, on the one hand, the Settlement Agreement includes a three-year energy
8 efficiency goal of 3.75%, but, on the other, specifically precludes APS’ recovery of the \$100
9 million in unrecovered fixed costs which will be caused by those efficiency gains.¹³

10 As well, certainly the 11% authorized return on equity is not generous based on recent
11 awards to other investor-owned utilities:

12 Q. (by Ms. Grabel) Mr. Hatfield, are you aware of any investor-owned utilities
13 that have authorized ROEs of a higher amount than the 11 percent authorized
for APS in the Settlement Agreement?

14 * * *

15 A. Yes...Alabama Power Company, 14.50; PG&E, 11.35; SoCal Edison, 11.50;
16 Tampa Electric, 11.25; Georgia Power, 12.25; Mid-American Energy, 12;
17 Entergy Louisiana, 11.05; Entergy New Orleans, 11.15; Central Maine Power
Company, 11 percent; Duke Energy Carolinas, 11 percent; and Green
Mountain Power, 11 percent.¹⁴

18 In summary, while as AECC’s Mr. Higgins put it, “every last nickel” was wrung from this deal
19 for consumers, the Settlement Agreement does move Arizona and APS a significant step down
20 the financial path to helping us compete for and hopefully win our share of the debt and equity
21 needs in this country’s intense capital competition.

22 ¹¹ Settlement Agreement, Section VII.

23 ¹² HR TR, p. 1073, ll. 8-9.

¹³ HR TR, p. 1668, ll. 6-19.

24 ¹⁴ HR TR, p. 2557, l. 17-p. 2558, l. 6.

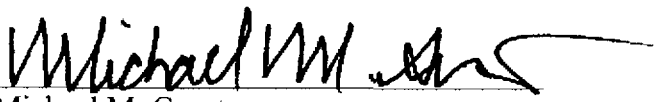
1 **CONCLUSION**

2 The Settlement Agreement advances a new vision for Arizona's energy future. Equally
3 important, it provides a well-balanced set of tools to allow the Company a chance effectively to
4 compete for the capital necessary to actuate that vision. Finally, because fuel prices are finally
5 giving us head room, the average residential bill cost of this new vision and tool set is less than
6 one percent.

7 The AIC urges the Commission to approve the Settlement Agreement.

8 RESPECTFULLY SUBMITTED this 9th day of October, 2009.

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